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The Politics of Adjustment and Coordination at the Regional Level: The Basque Country

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Abstract
Is globalization forcing non-"Coordinated Market Economies" such as Spain to converge on an Anglo-American model? This paper seeks to build on the hypotheses generated by the literature on "Varieties of Capitalism" to analyze the challenges of developing and sustaining coordination while adjusting for economic change. In particular it seeks to explore ways in which subnational factors promote the ability of socioeconomic actors to develop public-private institutions. By focusing on a particular autonomous region of Spain, the Basque Country, this paper will explore the role of institutional arrangements at the regional level in determining national adjustment. In the Basque Country the relative power and the particular interests of the regional state have been central factors in promoting distinctive patterns of coordination. At the same time, actors' preferences and policy outcomes have been constrained by the differences in the quality and configuration of institutional frameworks, political deals, and the existing economic structure.

The Puzzle of Coordination at the Regional Level

The Varieties of Capitalism (VoC) literature explains differences and similarities in economic policies and economic performance (Hall and Soskice 2001). It focuses on the institutional frameworks of market economies and identifies complementarities between institutional arrangements. It stresses that institutional arrangements come in packages that cannot be easily unbound, in which arrangements in one domain are dependent on arrangements in another. Reforms in one area would demand reforms in other areas. Institutional arrangements therefore tend to be characterized by clusters of complementary institutions. These fall into two broad types, the so-called *liberal* (LME) and *coordinated* (CME) market economies of Western Europe, North America and Asia. The complementary character of institutional arrangements make change problematic. Since the institutional arrangements on which CMEs depend are the product of protracted historical trajectories, it is very difficult for countries that do not have the institutional arrangements for coordination to develop them. When those countries seek to improve their economic performance, therefore, their best option consists of reforms that would change them in the direction of the LME model.

While this literature is useful in defining issues for empirical work, it is not clear how countries that cannot be easily classified as either a *liberal* or *coordinated* economy should be classified. Spain is one of them. According to the VoC literature, Spain (like France or Portugal) is characterized by strong strategic coordination in financial markets, but not in other domains such as labor relations. In these countries there have been historically high levels of state intervention in this domain, with the coordination of labor relations being led by the state (i.e., the minimum wage or the ability to translate a wage increase in a firm to the entire sector). Hence some VoC scholars argue that insofar as states become more reluctant to coordinate labor relations in those countries, the absence of institutions for coordinating labor relations like those in CMEs means that labor relations in countries like Spain will become more like those in LMEs, moving the whole economy in the direction of LMEs (Hall and Thelen 2005: 36).

Yet, this paper will show that developments in Spain point in the opposite direction. In Spain changing economic conditions, as well as the shifting interests of the economic actors, have promoted institutional changes at the national and regional level that have promoted further coordination (Royo 2008). They support the view that economic and institutional change is also the product of policy choices (Locke 1995), which have necessarily been impacted by political struggles.

In addition, the VoC literature has tended to underplay the role of institutional arrangements at the regional level in determining national adjustment paths, and the focus has been largely in developments at the macro level (Royo 2002 and 2008). Yet, in Spain there have also been remarkable cases of coordination among economic actors at the regional level. On the ground, Spanish firms have developed distinctive initiatives to compete more effectively and exploit niche areas in R&D. This paper seeks to analyze some of the initiatives that have promoted coordination at the regional level. They have been the result of the response of economic actors to a common set of negative (or positive) externalities, and have led to innovative strategies and institutional changes that have promoted coordination. These regional initiatives show that, despite similar political institutions and social structures, the economic actors have a range of resources and policy tools to address competitive challenges.

These innovative strategies have been possible in the context of the quasi-federal structure of the Spanish state that originated in the 1978 Constitution.[1] The literature on federalism has noted how attempts by central governments to implement reforms create new opportunities (and constraints) for actors at the regional level (see McDermott 2005: 34). Like in Italy (Locke 1995), regional governments in Spain have played an "enhancing" role for the "third Spain" of small and interconnected firms. Indeed, the development of separate regions in Spain has led to the diversification of industry and the development of regional strategies to attract investment. The Basque Country is an example of this approach.

In this paper I seek to explore ways in which subnational factors promote the ability of socioeconomic actors to develop public-private institutions. I seek to address the following questions: First, what types of factors contributed to the institutional innovations that have emerged in Spanish regions? Second, why were public and private actors able to build these new institutions? I argue that coordination at the regional level has been promoted by regional governments, who have played a crucial role. Cooperative arrangements have also been triggered by new competitive challenges and fostered by polices that promote the solution of collective-action problems.

The Basque Country has been particularly successful at forging new sustainable institutions and interfirm networks where the need for cooperation and the development of capabilities to respond to collective-action problems were lacking. Spanish regions have important differences with regard to their economic structure, political and socioeconomic organizations, institutions, legal regimes and sectoral regulations. The examination of this case helps capture the diversity of political and economic models within Spain, the variance in the ways the regional politics interact with the national ones, and the conditions under which institutional cooperation emerges at the subnational level (McDermott 2005; Snyder 2001).

In the Basque Country the process of institutional change was shaped by the capacities of the local regional governments, the existing social structure, and political strategies and incentives that led the economic actors to reshape their strategies. This paper shows that the development of institutional coordination at the regional level is a collective-action problem conditioned by political, economic, and social factors. In response to new economic and competitive challenges the Basque regional government and the economic actors have developed innovative capacities that have promoted further coordination. They have built a constellation of private-public institutions that have helped firms address collective-action problems. This was a remarkable development

[1]This process of decentralization is almost unparalleled, as it has led to a profound transformation of the political, economic, administrative, and institutional organization of the country. CCAA can enact laws that have the same force as Spanish laws, and their executive governments are not subordinate to the central one. While the other fifteen regions rely largely on the state for their financial resources, the Basque Country (and Navarre) was able to keep its historical rights (*fueros*). A special economic agreement (*concierto económico*) for the Basque Country grants the region the power to collect and levy all taxes except customs duties and the taxes on petroleum products and tobacco.

given the deep historical antagonisms among political and socioeconomic actors. Hence, this paper challenges the determinism of local, social, political, and economic structures for institutional change.

The examination of this case will show that institutional change is also dependent on different political approaches to reform in times of crisis. In the Basque Country the economic and sectoral crises led to political initiatives based on empowering economic and social actors so they could build new institutions that fostered coordination. These institutions have worked to address the collective-action problems of fragmented and small-sized enterprises with few skills, limited access to capital and resources, as well as an insufficient R&D and knowledge base.

In response to deteriorating economic conditions and new competitive challenges, the regional government engaged local socioeconomic actors in the development of new institutional initiatives to build coordination capacities. It became the leading instigator of efforts to build new ties among local companies, and to develop new associations and institutions to improve the collective capacity of local enterprises to address common challenges. The regional government took great efforts to encourage local firms to organize themselves so as to be able to do so by providing incentives and resources to small producers.

THE BASQUE COUNTRY: COORDINATION FROM THE TOP

The Development of Industrial Clusters [2]

In response to the economic crisis of the late 1970s and early 1980s, which almost led to the collapse of its industrial sector, the new Basque government led by the *lendakari* (the president of the Basque government) Carlos Garaikoetxea, decided to take drastic action in order to restore public confidence. One of the first decisions was to create in 1981 the *Sociedad para la Promoción y Reconversión Industrial* (the Agency for the Promotion and Reconversion of Industry, SPRI) within the Department of Industry, Commerce and Tourism. The aim of the new company was to provide back-up and services to Basque industry. SPRI is the parent of a group of companies which provide a response to the requirements of a business project from the first idea to actual implementation of the project. SPRI also uses certain instruments which allow small and medium-sized enterprises access to information technology, outward movements on overseas projects, location within business environments which are suited to the specific needs of each sector, and the use of venture capital funds to finance innovative and strategic projects.[3]

In the midst of the crisis and with escalating social conflict and unrest at the plant level, the first task of the new institution was to assist in the management of private companies. From this role it grew to promote the internationalization of Basque's businesses and their exports. Over the years SPRI continued expanding and focused on four strategic areas: Innovation, Globalization, Industrial Development and the Information Society, and it developed specific programs and activities to advance its goals in these areas. In addition, it developed new companies to further implement its goals: SPRILUR, which provides suitable and industrial facilities, the Technology Parks: (one in

[2] This section draws from the Harvard Business School case study by Porter (2005).
[3] From SPRI's website: http://www.spri.es/aSW/web/eng/spri/who/index.jsp.

Bizkaia, another one in Gipuzkoa, and a third in Álava, providing state-of-the-art environments for companies which require these features); the Sociedad De Capital Riesgo, which administers funds as minority and temporary stockholdings in business projects; and, lastly, the Business Innovation Centers, which smoothen the process of creation and development of company projects until these have reached maturity.

The second main initiative from the Basque Government was the development by the regional secretary of labor of a Department for Promotion and Economic Development in 1983 to supplement SEPRI's activities. This department was charged with the mission of expanding research and development (quite underdeveloped at the time), and to this end it opened several technology centers, a design center, and a robotics technology center. Furthermore, the Basque Government also focused on the improvement and development of infrastructure to support businesses and attract investment. For instance it created the *Ente Vasco de la Energia* (Basque Energy Board, EVE), which provides technical assistance to energy companies and invested in energy sources such as natural gas. Finally, the local secretary of education developed the *Technology Research Network*, which was charged with the establishment and management of new technological research centers to further the cooperation of local companies and universities on technology projects (Porter 2005: 7–8).

In 1986 the Basque Government, under the leadership of a new *lendakari*, José Antonio Ardanza, launched a *Plan the Relanzamiento Excepcional* (the Exceptional Relaunch Program) to promote the development of SMEs, stepped up its investment on physical infrastructure and energy resources to facilitate businesses' operations and further attract investment to the region (which has been hindered by the ongoing conflict with the Basque terrorist Group, *Esukadi Ta Askatasuma* – ETA), and launched the program "Euskadi Europa 1993," which included physical infrastructure investment and social programs in health and education aimed at preparing the region for the European Single Market.

By the mid-1980s when the economy was emerging from the depths of the crisis, the Basque government (and in particular its health and labor secretary, Jon Azua) shifted focus and instead of propping up and restructuring troubled companies, it started advocating a long-term strategy based on the development of manufacturing clusters. However, this strategy was delayed when the 1987 Basque Parliamentary elections led to the formation of a coalition between the Basque Nationalist Party (PNV) and the Socialist Party (PSOE) and Azua left the government to become CEO of the Bilbao Stock Exchange. From this position he retained a group of advisors to evaluate the state of the Basque economy, and they identified nine clusters[4] based on established sectors and also new possible opportunities: Machine Tools, Automotives, Steel, Port and Logistics, Paper, Financial Services, Fisheries, Tourism, and Agroindustry. While there seemed to be support for this approach, the government did little to advance this program (the

[4]According to the *World Economic Forum* (http://www.weforum.org/en/index.htm), "Clusters are geographically-centered groups of related firms and industries operating in an environment characterized by a high degree of specialization, intense competition and a critical mass of highly educated employees from which to extract competitive advantages… This permits the generation of a series of operative synergies that constitute sources from which to extract competitive advantages."

only exception was the Financial Sector cluster, which was developed under Azua's leadership) (Porter 2005: 8–9).

It was only the crisis of the early 1990s, which led to the collapse of the European Monetary System, and three consecutive devaluations of the Spanish peseta, that created a new sense of urgency and prodded the Basque government to act. The crisis caused a dramatic surge of unemployment (it reached over 20 percent by 1993) and a new industrial crisis. Azua was named new Secretary of Industry and from this position he was able to advance his previous agenda. His department identified critical shortcomings in the Basque economy: limited skills in areas such as strategy, marketing, and international competition; little emphasis on R&D; lack of competition; and dependency on government intervention. The Basque Government was interested in exploring all options to address these issues, and they invited the competitiveness scholar Michael Porter to visit the Basque Country. During his visit Dr. Porter stressed that in the microeconomics of competitiveness, everything mattered, and also that successful implementation of a plan would largely hinge on the understanding of the complex interrelationships between agents. He emphasized that a new approach based on clusters, would require a reshaping of the functions of the private sector, government, associations and institutions. Nevertheless, policymakers understood that this approach could be a very useful industrial policy instrument, which made it very attractive.[5]

As a result of his visit and Porter's recommendations the Basque Government decided to move full speed with the strategy to develop manufacturing clusters. They developed a practical action plan, "Cluster Initiatives," which was "an organized effort to increase the growth and competitiveness of clusters within a region, involving companies, Government and/or the research community." This was a proactive attempt at institutional change. The policymakers understood that "mature cluster initiatives usually result in stable structures, called Institutions for Collaboration, or Cluster Associations in the Basque case."[6] Once they decided to proceed this way they determined the group of priority clusters and over the following years they developed the different Cluster Associations.[7]

The Basque Government also capitalized on existing opportunities (such as the restructuring of the steel sector, which led to a shift from basic steel production to the development of mini-mills; or the decision by McDonnell Douglas to establish a major new supplier, which led to the establishment of a public-private planning group) to learn about companies and the process of building clusters. The government developed a new program called the "*Las Tres Rs: Rescate, Restructuración y Reorientación Laboral*" (the Three Rs: Rescue, Restructuring, and Labor Reorientation) to help companies compete internationally, and worked closely with local companies from the identified clusters. The efforts to develop these clusters were overseen by the secretary of industry and the SEPRI. While many companies were skeptical (and many refused to join), the government was able to convince them of the benefits. The enticement of government support was a powerful incentive (Porter 2005: 10–11).

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[5]Presentation by Juan Manuel Esteban, coordinator of Cluster Policy, Department of Industry, Trade and Tourism, Basque Government. Opatija, April 19–21, 2007.
[6]Ibid.
[7]Ibid.

This strategy was underpinned by the Basque Government's strategic decision to work with the principal economic and institutional stakeholders to sponsor initiatives to improve the competitive position of Basque firms. These included two industrial policy plans (1991–95 and 1996–99), an Industrial Technology Plan (1993–96), and a Science and Technology Plan (1997–2000). A key component of all of these initiatives was the objective of promoting cooperation among firms as a mean to compete in international markets; as well as the attempt to increase the commitment of human and financial resources by Basque companies to R&D. As a result, starting at the beginning of the 1990s and as part of the implementation of the Basque Government's Competitiveness Program, the main Basque industrial sectors developed sectoral organizations to promote technical and commercial collaboration among companies from the sector and with third parties. The first cluster to emerge was the Machine Tools Cluster (1992), which was quickly followed by the Appliances Cluster (1992) and the Automotives Cluster (1993). They were followed by nine others (see Figure 1).

Figure 1: The Twelve Priority Sectoral Clusters in the Basque Country

Aeronautics HEGAN: Aeronautics Cluster Association of the Basque Country (www.hegan.com)

Automotive ACICAE: Cluster Association of Car Industries and Components of Euskadi (www.acicae.es)

Audiovisual EIKEN: Audiovisual Cluster of Euskadi (www.eikencluster.com)

Knowledge Cluster Association of Knowledge in Business Management (www.clusterconocimiento.com) (www.portaldelagestion.com)

Electronic Household Appliances ACEDE: Cluster Association of Household Appliances of Euskadi (www.acede.es)

Electronics, IT, and Telecommunications GAIA: Association of Electronics and Information Technologies of the Basque Country (www.gaia.es)

Energy Energy Cluster Association (www.clusterenergia.com)

Maritime Industry: Basque Maritime Forum. Association for the Promotion of the Basque Maritime Industry (www.foromaritimovasco.com)

Machine Tools AFM: Spanish Association of Machine Tool Manufacturers (www.afm.es)

Environment ACLIMA: Cluster Association of Environmental Industries (www.aclima.net)

Paper CLUSP AP: Paper Cluster Association of Euskadi (www.clusterpapel.com)

Port CPB: Port Cluster of Bilbao (www.uniportbilbao.es)

Source: Euskadi.net (http://www.lehendakaritza.ejgv.euskadi.net/r48-467/en/contenidos/informacion/cluster_sectoriales/en_cluster/clusters_s.html)

From an organizational standpoint the main goal was to achieve general coordination and to break down the formal boundaries among members within sectors and boundaries among sectors. Hence each cluster association has a vertical head, reinforced with twelve SPRIT staffers, and also a horizontal head, one on each strategic area. The horizontal heads are at the same time heads for horizontal standard policies. Their role is to link cluster policy and horizontal standard policy. Moreover, the civil servants of the Department of Industry and SPRI staff (with extensive experience and knowledge of each area) attend all the Boards of Directors meetings, and other committee meetings, but they do not vote. Their main role is to provide support and advice, but not to interfere or impose. [8]

In addition, the government developed a new *Department of Industry and Clusters* to work closely with the companies to identify goals and needs and to develop plans to achieve their goals. The process was very much instigated by the government (and in particular by this Department) but the government still avoided excessive intervention and adopted a flexible strategy to let groups form naturally.[9] Yet, it still played a central role facilitating cluster meetings, providing funds for projects, and making cluster representatives focus on long-term goals.

The Basque Government and the companies were looking for increasing internationalization, technology development, quality and excellence in management, and improved logistics, and they accepted that these goals (and the strategic competitive strategic challenges facing Basque companies) could not be simply addressed by individual actions from individual companies. Hence they agreed that improving the competitiveness of Basque companies would require cooperation and coordination. In this regard, they felt that the clusters could play a central role as "net servers" with a catalytic function, because they would intensify the interactions and speed of communication among members of the cluster. With the clusters they sought to "gather and spread strategic information; identify strategic challenges and potential synergies; evaluate the potential synergies, and finally identify and promote cooperation groups with common interests in order to generate cooperation projects."[10] Initially the program was funded with a modest amount: €2.3m per year for the whole program.

In order to improve the operations of these clusters and to create uniform structures, the Basque Government named a Board of Directors for each cluster, which brings together the CEOs of local companies. This Board oversees a general manager who is in charge of managing the cluster committees. In addition the Basque Government asked each cluster in 2000 to develop a process to capture data and information; identify areas of cooperation within clusters, evaluate potential synergies, and form groups to realize them (Porter 2005: 16).

This strategy was supplemented with a strong push toward the outside world with the Basque Government giving incentives and subsidies to companies to establish links abroad and develop international units; as well as also opening representative offices and developing bilateral trade promotion agreements with other countries (Porter 2005: 14).

[8] Presentation by Juan Manuel Esteban, April 19–21, 2007.
[9] One member of the Automotive Cluster acknowledged that "without the government we wouldn't have existed. The government encouraged us to think about our long term vision when we may have been swept up in the daily business of running our companies" (Porter 2005, p. 12).
[10] Presentation by Juan Manuel Esteban, April 19–21, 2007.

In addition to the clusters, the Basque Government also developed technology parks. The first one was Bizkaia's Zamudio Technology Park, which was inaugurated in 1985, and was followed by the Alava Technology Park (1992) and the San Sebastian Technology Park (1993). The parks are owned by the regional government with the participation of the local administration. These three parks were the first technology parks in Europe to be awarded ISO certification. They provide facilities for 230 companies with an annual turnover that exceeds €2 billion. Zamudio, for instance, hosts R&D operations of companies such as Rolls-Royce's Spanish partner ITP, Alcatel or Air Liquide, and it has been chosen by the EU as the headquarters of the European Software Institute (ESI). They work on more than 1,500 research projects each year and spend on R&D more than 200 million Euros a year (about 30 percent of total R&D expenditures in the entire region).[11]

The Basque Government has also worked actively to promote innovation, technology, and science. To this end it developed SARATEK, a private, not-for-profit association involving eighty-nine Basque science and technology agents working in R&D+I, with 10,000 research workers in all. The network includes eleven technological centers: TECNALIA, which is the largest private research corporation in Southern Europe, which brings together R&D businesses, IK4 (6 technological centers), as well as universities and private and public institutions working on development, innovation, and technology transfer.[12] It seeks to generate and develop scientific and technological knowledge, to improve business competitiveness. SARATEK works in many areas, including information and training, the promotion of cooperation and the creation of science- and technology-based businesses.

Other government initiatives included the creation of *Ikerbasque*, the Basque Foundation for Science, which aims to help develop scientific research in the Basque Country by attracting researchers and helping them establish themselves; and the *Institute for Competitiveness and Development*, a privately-managed, public-service initiative linked to *Deusto University*, charged with the mission of providing support to the public administrations, social and economic agents, and all the universities in the Basque Country in the field of competitiveness.

A Regional Model of Coordination[13]

As we have seen in the previous section, the Basque initiatives are a case of coordination from the top, with the Basque Government playing a crucial role. But it did not happen by accident. One of the key elements that fostered these initiatives was the timing: it all started with the collapse of the authoritarian regime at a time when Basque companies wanted to expand but were facing one of the worst economic crises of the previous decades in sectors such as steel, shipbuilding and paper, in which the structure of costs was no longer competitive. This led to devastating job losses (around 250,000 jobs were destroyed at the time in a region with a population of two million people). This crisis, however, provided the impetus (and urgency) for change. The process of

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[11]See "Economy in the Ascendancy," in *FDI:ForeignDirectInvestment*, April 2004.
[12]SPRI: http://www.usa.spri.net/aUS/web/en/spri/index.jsp
[13]For this section of the paper I traveled to the Basque Country in 2003 and interviewed the leaders of the main business associations, chambers of commerce, regional government, unions and business firms participating in the clusters.

change was led by two main actors: on the one hand there were small- and medium enterprises, which needed to develop coordination mechanisms to address collective action problems. They recognized that in an increasingly globalized world with intensifying competition, their small size and lack of cooperation would hinder their efforts to compete effectively in international markets.[14] On the other hand, the new democratic Basque Government was compelled to take immediate action to address the mounting crisis and intensifying social conflict. The priority was to develop a shock plan and to address the mounting industrial crisis with a plan for industrial restructuring. This plan planted the seeds of collaboration between the private and the public sector: the government was willing to provide funds for the restructuring of these companies, but only in exchange for certain conditions, such as the development of technological innovations.

Once the process of industrial reconversion was completed in the mid-1980s, the Basque Government shifted gears and started focusing on the promotion of products and new industries, at a time when unemployment, inflation, and interest rates were still quite high, and access to capital (and long term finance) was still significantly limited because of the existing quasi-oligopoly in the finance sector. The government played a very active role developing an industrial policy and involving economic and social actors in the development and implementation of these policies, including business associations, universities, training centers, trade unions, as well business schools. This helped set a tone of collaboration and a culture of consultation and participation.

The regional government also helped define the key priorities: technological and knowledge development, innovation, and training. In this regard, one of the first steps, as we have seen, was the development of the knowledge cluster in 1996, which was instrumental in developing supply and demand for the creation of new projects, and also in convincing economic actors that, in a context of increasing competition and higher costs, a model based on low costs was no longer viable and had to be replaced by a model based on technology and strong management capabilities.[15] To facilitate this transition the Basque Government focused on developing a new environment that would be very supportive of R&D efforts and new technologies. They drew inspiration from the Italian industrial districts (Sabel 1984), and the visit from Dr. Porter acted as a definite catalyst to implement the push for this shift.

Furthermore, the Basque Government was also instrumental in convincing Basque firms of the need to internationalize in order to force them to improve their competitiveness, reduce their quasi-complete dependence on the Spanish market; and also diversify. This change, however, required a qualitative transformation not only in their production systems, but also in their management and organization. Yet, SMEs simply lacked the size to make this transition by themselves, and hence they had to find ways to develop mechanisms to coordinate with other firms and the Basque Government to resolve collective-action problems.

The lack of access to capital was one of the main instigators that led companies to start developing networks to raise funds and to promote exports.[16] At the same time, given the size and limited resources of the small- and medium enterprises, they were de-

[14] This was stressed in my interviews with business leaders in May 2003.
[15] Interview with Andrés Arizcorreta former president of the Knowledge Cluster, May 7, 2003.
[16] Interview with Jesús Alberdi, leader of ELKAR, May 7, 2003.

pendent on government intervention and support in multiple areas, such as capital and development of new technologies. The Basque Government responded to these demands from the private sector and started implementing new action programs, and developing technological centers. The funding of these initiatives was often split between the government and the private sector, which benefited from the new technologies. It was in this context that SPRIT was created, with the initial focus on promoting the creation of new enterprises. One of the first instruments for achieving this goal was the plan to work on the rationalization of the industrial landscape (*Industrialdea*) and the development of industrial centers (*polígonos industriales*). The government would lease land for eight to ten years to companies at the industrial center with a prearranged sale price, and the company would buy the property once it was already established and consolidated.

The government was also involved in funding initiatives. Companies faced two major barriers: lack of access to long-term capital and high financial costs (which were significantly higher than in the rest of Europe at that time). Originally, the reference was to the venture capital model of the Anglo-Saxon countries. However, the private sector faced significant hurdles in raising capital: first, venture capital firms barely existed. Furthermore, the country lacked a culture of savings (and most of the savings went to Treasury Bonds). Finally, the secondary market was virtually inexistent, and public money was scarce because the central government still faced a significant public deficit. The central government passed a new law of *Sociedades de Garantia Reciproca* (Reciprocal Guarantee Societies) in 1978 and the Basque social actors took advantage of the new legislation creating a management fund in charge of managing capital risk funds. Yet, it was still difficult to find investors and they had to turn to private stockholders (mostly companies) that invested in the fund to facilitate the creation of new firms. In the end they developed capital risk societies with diverse purposes. For instance, the one focusing on new (and risky) technologies was mostly funded with public funds, while others with more moderate risks were funded with private funds. These initiatives were supported by tax breaks, which promoted the development of private societies. The government also played a role through the Basque savings and loans, which helped companies in crisis (during the crisis of the 1980s they bought participations in companies such as ACF). The savings and loans took in deposits and bought stocks in the companies, thus providing a stable stockholder nucleus to these companies. which in turn have allowed them to focus on the long-term and to make investment decisions.

Once the seeds of cooperation were planted they started to flourish. For instance, in San Sebastian private firms joined in 1980 to develop ADEGI, the Gipuzkoa business association. This association emerged in response to the brutal crisis of the 1970s, which has led, as we have seen, to the dismantling of large companies, which in turn had devastating effects on the region's SMEs. They had two kinds of members: participating members (stockholders), and protective members (sponsors, commerce chambers, and the Basque Government). Private businesses have the majority of the capital.

One of the main objectives of the new association was to facilitate access to capital to participating member firms. To better fulfill this role the Basque businesses created ELKARGI, a reciprocal guarantee company. One of their first actions was to sign an agreement with the Basque Government to offer long-term funding to its members at subsidized interest rates, with ELKARGI providing bank guarantees (to lower the risk premium, and thus allow member firms to receive lower interest rates). It also provided participatory loans, in which ELKARGI participates in the evolution of the business. The initiative was revolutionary in Spain: the criteria for giving loans were not only based on performance, but on the economic expectations of a future benefit (as venture capital does) (i.e., firms have to be able to generate resources to have enough funds to return the loan). ELKARGI has also promoted and funded innovation initiatives from participating member firms providing guarantees, and has facilitated the bureaucratic process.

Another area in which the Basque Government has played a central role was in professional training. While large companies had their own internal training systems, SMEs lacked the resources and knowledge. This became a central priority in a context marked by constant and rapid technological changes that required urgent upgrading and updating of skills. Hence the focus from all parties turned to enhancing the education system at all levels to improve human capital productivity.[17]

As a result, professional training has also been an important area of cooperation. The professional training system in Spain has traditionally been quite discredited and separated from the real needs of companies. In the Basque Country the economic and social actors have tried to address this shortcoming and have worked together to develop a well-functioning professional training system. Once again the Basque Government played a central role. The economic crisis between 1985 and 1993, which caused a sharp increase in unemployment, created the urgent need to "recycle" those people and provide them with new qualifications to be able to find new jobs. Seventy percent of the demand at the time was for people with professional training skills.

To respond to this demand the government approved in October 1997 the "Basque Plan of Professional Training," which included the development of an Integrated System of Qualifications and Professional Training. This plan involved three government departments: labor, industry and education, as well as the social actors and the professional training centers, and it led to the establishment of the *Basque Council of Professional Training*. The plan was articulated around three main institutions. First, the *Basque Observatory of Professional Training*, which was put in charge of analyzing and researching in detail developments in the Basque labor market, and to predict patterns for the future. It is closely connected with the firms and collects data from the national office of employment (INEM), as well as from the press and other observatories.

The second institution was the *Basque Institute of Qualifications and Professional Training*. Based on the observatory's findings this institute is in charge of determining the qualifications in individual productive sectors and to develop programs geared to providing the necessary training in a short period of time (usually no more than 3–6 months in order to satisfy urgent demands from firms). They have high competence standards that are determined with the participation of the representatives from nine key sectors for the Basque economy. The results of their work are then presented to trade union and business technicians who have to approve the technical specifications, which are then ratified by the *Basque Council of Professional Training*.

The last institution is the *Basque Agency for the Evaluation of Competences and Quality*, which is charged with the evaluation of the whole system and implements a process

[17]Interview with Felix Iraola, leader of the Chamber of Commerce, San Sebastián, May 8, 2003.

to recognize and make official the skills that have been learned by workers, which then become part of a registry of certifications of competences.

The program is articulated through agreements between schools, companies and the Basque government, which provides funds and insurance, and the whole program is funded by companies and the Basque Government (partly with funds from the European social funds). The system also provides businesses with funds for training and adaptation to new technologies.

CONFEBASK, the Basque Business Confederation (established in 1983 by the three regional business associations: ADEGI-Gipuzkoa, CEBEK-Bizkaia, and SEA-Alava) also played a central role in the initiative to improve the professional training system with two main objectives: to respond to the need for specialized skills of the Basque companies, and also to improve the prestige of the professional training system and improve the employability of workers. To this end they worked with the Basque Government and took advantage of a legislative change in the national law regulating this field, which now allows students to do their internships in companies. In addition, business associations such as ADEGI have their own well-developed training programs.

Since the Basque Government started the program it has worked with over 12,000 students, which has improved significantly their employability (reaching rates of almost 100 percent in certain industrial sectors). The success of the program is also proved by the growth in registration rates of professional training programs (27,953 in the 2005–06 academic year) despite stagnant population rates. The Basque Government is now spending more in professional training (802.801 billion Euros in 2005 or 39.7 percent of the total) than in higher education (252.237 billion Euros, or 12.5 percent), and more people complete professional training programs (30 percent in 2004–05) than university programs (25.2 percent).[18]

The government has also established an assessment mechanism to poll the companies that employ graduates from the program, in order to guarantee that students are learning what the companies need. Finally, while in the rest of Spain there is a problem with the high levels of temporary work (almost 31 percent in 2008), which results in high turnover rates, in the Basque country many firms have understood that if they have to invest in their workers it is in their best interest to keep them long term. Hence, firms such as ACF made strenuous efforts to keep the turnover to a minimum and the overall temporary rate is significantly lower (23.2 percent in 2005).[19]

The professional training system has also played a significant role in technology transfers because many of the schools have better and more modern equipment than the companies, which can now hire employees who can work with the latest technologies. Driven by the example of companies, the schools themselves, have made a push for quality, and many have achieved ISO quality certification, which has enhanced their prestige, and hence their ability to recruit students. It is a holistic approach with a very

[18]Data from *Memoria Socioeconómica Comunidad Autónoma del País Vasco 2005* (Bilbao: Consejo Económico y Social, 2006), p. 260.
[19]Interview with Andrés Arizcorreta manager of ACF, May 7, 2003.

inclusive and responsive process that guarantees that the training programs respond to demands from the firms.[20]

Cooperation has not only flourished among businesses or between business and the regional government, but also with unions. And this despite the fact that in addition to the main confederations (CCOO and UGT), the Basque Country has a third union, ELA-STV, which has around 40 percent of representativeness, and almost 70 percent of the collective agreements could be signed without UGT and CCOO. This has been facilitated by a strong cooperative culture (which has been an important factor, for instance, the Basque Country has some of the most successful and larges cooperatives in the world like *Mondragon*) and the institutionalization of cooperation mechanisms such as the creation of the tripartite *Basque Economic and Social Council*, which has played a central role at the regional macro level building bridges among the social actors and fostering a culture of consultation and consensus. But cooperation has extended to the micro level. Some companies (such as ACF) have gone as far as ~~to~~ selling stock to the unions at a subsidized price (they control 18 percent of the stock), and offering unions the possibility of participating in managerial decisions (something similar to the German codetermination model).

In the area of industrial relations there has also been significant cooperation between unions, employers and the Basque Government, and this despite the relevance of national-level bargaining and the interference of political factors linked with the sovereignty dispute.[21] The social actors have been able to overcome historical conflicts and antagonisms, aggravated during the dictatorship when employers were largely associated with the regime. Unions now accept and do not question the role of the private sector and recognize that companies have to fulfill certain requirements in order to survive and compete.[22] The Basque Government has been very active in this field as well. The *Council of Labor Relations* of the Basque government, a bipartite institution (with seven representatives from CONFESBAK and seven from the unions–three ELA, two CCOO, and one LAB/UGT), has played a critical role in areas such labor mediation and in refereeing industrial collective conflicts, in which it pioneered an agreement in 1984.

The wage bargaining structure is regulated by national regulations. For most companies minimum salaries are negotiated at the sectoral level and they do not have the flexibility of lowering them or making substantive changes. Yet, CONFESBAK plays a central role in collective bargaining, although there are differences based on regions. ELA supports a model based on provincial collective agreements that set minimum standards (including for salaries) and are then complemented by agreements at the firm level (which is the prevalent model in Guipuzkoa).[23] Basque employers, for their part, are trying (as in other parts of Spain) to extend the scope of collective bargaining to make it more comprehensive and include issues such as the management of human resources, or the organization of the firm and the deployment of human capital. They are also pushing for the decentralization of collective bargaining and to establish the firm as the bar-

[20]Interview with Jorge Arevalo, vice counselor for Professional Training of the Basque Government, May 9, 2003.
[21]Interview with José Miguel Unamue, from ELA, May 9, 2003.
[22]Interview with Martin Auzutendi, counselor of labor relations of the Basque government, May 9, 2003.
[23]Interview with José Miguel Unamue, from ELA, May 9, 2003.

gaining unit, in order to better take into account the reality of specific firms and the increasing individualization of industrial relations. Unions, however, resist this push for decentralization because they are afraid it will hurt the principle of solidarity.[24] The social actors have been reasonably flexible to accommodate each other's demands and the institutional structure has facilitated agreements. Overall, there is consensus that the system works relatively well: labor conflict is limited and the number of strikes has declined (i.e., the number of working days lost has decreased from 1,100 in 2000 to 603 in 2005), and there has been wage moderation.[25]

Finally, the clusters and technology parks have also played a very constructive role in corporate governance and the rules governing intercompany relationships: that is, technology transfer, standard setting and competitive policy. For instance, the process of registering patents, which is considered quite bureaucratic (and individualistic) throughout Spain, has been facilitated by business associations such as ADEGI (the Gipuzkoa Business Association), and the technology centers are playing a central role in the transference of technology to firms throughout the region.

Outcomes and Performance

The institutional outcome of these initiatives has been notable. There are ten applied technology centers, thirteen R&D centers, four research laboratories, two public research organizations, and three technology parks (Porter 2005: 15). Other tangible results include the creation of several Export Consortiums; the development of technological projects "interclusters" (such as Electronics for Automotion, Automotion-Machine-Tool, or Energy-Environment), and finally there have been impressive results in Excellence in Management evaluated according to the European Foundation for Quality Management, (EFQM) model.

Other results are less tangible and difficult to measure, but they are still very important. For instance, the clusters have contributed to foster trust among members, and cooperation among competitors. Furthermore, they have helped to break down the traditional barriers between the public and the private sectors and helped reaffirm the principle that progress was contingent on public-private collaborations. Finally, they have promoted a common strategic orientation and shared long-term objectives.[26]

The economic results have also been remarkable. The Basque Country has the highest disposable per capita income in Spain (it grew from 74.37 percent of the EU average in 1980 to 100.2 by 2000, and 128.2 in 2006), and only five EU countries (Austria, Denmark, Holland, Ireland, and Luxembourg) have higher per capita GDP than the Basque Country. Unemployment fell to 3.4 percent in 2007, which has been supported by wage moderation. Moreover, the Basque GDP has been growing since the 1980s at a faster rate than that of Spain and the EU.

The effort in R&D has also been very important. According to EUSTAT data in 2004, 769 million euros were spent in activities related to scientific research and techno-

[24]Interview with Eduardo García Elosua, leader of CCOO in the Basque Country (May 8, 2003).
[25]Interview with Martin Auzutendi, counselor of Labor Relations of the Basque government, May 9, 2003.
[26]Presentation by Juan Manuel Esteban, April 19–21, 2007.

logical development (1.44 percent of GDP, compared with 1.07 percent in Spain).[27] This investment has translated into innovation. According to EUSTAT data, during the 2001–03 period 16.3 percent of the establishments were innovators, and this percentage reaches 31.9 percent if we only take into account establishments with more than nine employees. This is 2.2 percentage points higher than the average in Spain. The total expenditures in technological innovations reached 2,010 million euros in 2004 (1,029 from the industry and 964 million for the service sector), which represents 3.8 percent of the GDP (1,836 million in 2003 or 3.9 percent). Most of these expenses have been in internal R&D (38.3 percent) and in the purchasing of machinery (39.6 percent).[28]

Furthermore, industrial production has also experienced extraordinary growth as a result of the diversification of industrial production in the region, which has expanded from the traditional activities derived from metal to now include sectors such as chemicals, petrochemical and refinery, industrial electronics, nanotechnology, robotics and biotechnologies.[29]

Finally, Basque companies have been responding successfully to the competitive challenge of globalization and they have been increasing their presence in other countries. The degree of economic opening of the Basque economy has increased (i.e., it was 123.25 percent of GDP in 2004 compared with 53.10 percent in Spain, 71.14 percent in Germany, or 55.2 percent in the United Kingdom), and the exporting tendency of the Basque economy (exports of goods and services over GDP) has grown to 30.65 percent, a figure well above other countries (exports of goods and services over GDP represented 26.64 percent in Italy, 25.97 percent in France, and 24.90 percent in Spain).[30]

Conclusion

This paper has sought to analyze the impact that different institutional settings have on business activities and also the possibility of building coordination capacity in countries that lack a propitious institutional framework. I have shown that institutional change is dependent on different political approaches to competitive pressures. Economic actors develop the institutions that they need, but it is necessary to explain how, why and when.

While the VoC approach theorizes the complementarities among forms of institutions that tend to make them persist, it does not say much about how those complementary institutions come about and how they change while preserving complementarities. In other words, it does not explain sufficiently how institutions with important complementaries come into being where they didn't exist. This paper seeks to address this shortcoming by exploring why (and how) change happened in a Spanish autonomous region: the Basque Country. It looks at the different varieties of coordination as changing systems, not as equilibrium systems.

[27]Data from *Memoria Socioeconómica Comunidad Autónoma del País Vasco 2005* (Bilbao: Consejo Económico y Social, 2006), p. 120.
[28]Ibid., pp. 120–126.
[29]SPRI: http://www.usa.spri.net/aUS/web/en/spri/index.jsp.
[30]Ibid.

The article makes three important contributions to the Varieties of Capitalism literature (VoC). First, by examining the political processes that brought the institutions into being, and showing the decisive role that subnational governments can play in creating institutions and making them work, it brings the political back onto center stage (Thelen 2004). The paper looks at coordination as a political problem in which actors are constantly assessing and evaluating institutions, and views stability as a political outcome. It focuses not merely on the individual action of actors, but also on their collective actions as well (see Hancké, Rhodes, and Thatcher 2007: 4).

Second, by "bringing the state back in," it addresses the VoC literature's tendency to downplay state action and largely ignore its distinctive role in CMEs and LMEs (Schmidt 2006: 9–11). This is a particular shortcoming given that the role of the state remains higher in Spain than in CMEs and LMEs. Indeed, as we have seen coordination in the Basque Country not only depended on the organizational capacities of actors, but also on state intervention, which also influences the shape and character of coalitions (Molina and Rhodes 2007). By deconstructing state action and examining the degree and form of government actions and practices, the paper considers state action in all its complexity (both at the national and regional levels).

Finally, the focus of the VoC literature has been largely on national models of coordination. This approach, however, underplays the role of institutional arrangements at the regional level in determining national adjustment paths. By focusing on a particular region, the Basque Country, this paper looks at the dynamics of coordination and adjustment at the regional level.

Indeed, the analysis of the Basque case shows that it is possible to create institutions to foster coordination at the regional level, and this even in a region that has been ravaged by conflict and terrorism. It illustrates the conditions under which it is feasible for countries to develop a sustainable path toward coordination (McDermott 2005: 8). First, crises and economic shocks provide moments of opportunity that open up the space for change and for new coalitions to emerge. Second, as we have seen in the case of the Basque Country, institutional change is more likely to succeed when state policies and actions try to redress resource asymmetries and resolve existing problems in the provision of collective goods. Coordination is also more likely when associations are encompassing in membership, inclusive and established to address specific problems or challenges. Finally, government actions should be aimed at improving and facilitating collaboration among groups, sharing of resources and the achievement of common goals.

These initiatives have been characterized by the following common threads: First, public-private network of organizations; second, public and private funding; third, pooling of resources to develop services to address common collective action problems; and finally, the use of these institutions as deliberative bodies to identify new challenges and develop further areas of cooperation (see McDermott 2005).

The Basque model of coordination is a model of state-influenced "coordination from the top," which has been highly dependent on state intervention. However, while the Basque Government has played a central leadership role in the coordination efforts, it is important to stress that its main function has been to support and complement the actions of the private sector. The clusters were based on a real private-public partnership. It was clear that the role of the government was not to choke the efforts of the private sector, but mostly to define the mission and the objectives of the cluster. Indeed it leads but it does not impose. Cluster membership was open to all the organizations that were part of the "natural" clusters, and the success of these initiatives has been based on factors such as shared values and goals; the presence of a good facilitator (usually from SPRIT or the Department of Industry, Trade and Tourism); regular meetings (almost daily) and interactions between civil servants and the heads of the Cluster Associations; and finally a high level of consensus on the decisions and actions.[31] In sum, the public sector has given independence to the private one, and has not become involved in the management of private firms.[32]

One of the key for the success of this model has been the independence from political interference. Civil society is strong, articulated and well organized in the Basque Country, and, therefore, it is not easy for the public sector to influence or interfere. Firms and business leaders have bought into the model because they have valued the role that public institutions have played in fostering coordination among economic actors.[33] The strategic choices of the economic actors have been shaped by the local economic orders in which they were situated. Much like in Italy, in the Basque Country "economic actors embedded in local economic orders possessing dense but relatively egalitarian socio-political networks were able to share information, form alliances, build trust, and hence negotiate the process of industrial adjustment" (Locke 1995: 175).

And this happened at the time when private firms needed support from the Basque government to deal with the devastating consequences of the economic crisis of the 1970s-1980s, as well as the new competitive challenges emanating from European integration and the emergence of new competitors from developing countries. Companies realized that they had to focus on exports and they needed a new regulatory and institutional framework that facilitated this transition.[34] Hence companies demanded a normative framework and the financial support, which made the development of these coordination institutions possible.

Another relevant factor to account for the success of this model has been the importance of moving from the bottom up, and responding to demands from the firms (as opposed to trying to impose decisions on the firms), and to grow little by little. An additional contributing factor has been the fact that key players were not only intimately connected, but also that there was a fluid transition between the public and the private sectors. Many of the leaders of many of the business association and commerce chambers had served in the public sector as well and vice versa; many companies' leaders had also served in the public sector and public servants had also made the transition to the private sector. This fluid movement from the private to the public sector (and vice versa) facilitated communication, cross-fertilization, and fostered a culture of dialogue in which the players were looking at the overall and long-term interests of the region, not

[31] Presentation by Juan Manuel Esteban, April 19–21, 2007.
[32] Interview with Joss Rubia from COFESBANK, May 8, 2003.
[33] Interview with Andrés Arizcorreta, director of the rolling stock producing company ACF, which employs over 20,000 people and has operations all over the world on May 7, 2003. He had been president of the knowledge cluster.
[34] Interview with Felix Iraola, leader of the Chamber of Commerce, San Sebastián, May 8, 2003.

just merely at their parochial ones.[35] This fostered a culture in which regardless of where the initiative originated (whether it was in the private or public sector), there was a convergence of efforts. The small size of the Basque Country has facilitated all this. Finally, cooperative relations in the Basque Country have been fostered by the long *Foral* tradition of good administration, as well as a strong and entrenched cooperative culture (marked, as noted earlier, by the success of some of the largest cooperatives in the world such as Mondragon). This culture is quite unique to the Basque Country. Finally, it is important to note that there is not a homogenous and single model of cooperation throughout the Basque Country.[36] Indeed, coordination is more developed and has worked better in some regions than others.

The Basque Country shows the critical importance of geographical location and physical proximity, which generates important benefits and allows for effective responses to the challenges of globalization. The new ultra-competitive environment requires companies that are flexible to adapt to shifting circumstances and changes in demand. This environment will demand flexibility from companies and workers and also human capital with adequate skills. Yet, only cooperation mechanisms, along the lines of the ones that we have examined in this paper, will allow the private and public sectors to educate people to succeed in this new system and optimize the use of new technologies. Therefore, places such as the Basque Country, with an industrial base of SMEs that uses medium-high technologies and has a high innovation capacity and an educated labor force are well-positioned to compete, provided they constantly enhance their capacity to educate and train people, as well as their ability to innovate to develop processes and products with high value-added and high-technology capacity. They will also have to identify and focus on sectors of high demand. In the end, the key will be the management of knowledge in order to continue generating qualified human capital to attract investment and innovate.

[35]This model has has gravely deleterous effects in countries like the the U.S. or France, where the so-called "revolving door" or *pantouflage* has often led to cronyism, corruption and the diversion of state functions from their public purposes. It is too early to predict whether the same outcomes will take place in the Basque Country.

[36]Interview with Felix Iraola, leader of the Chamber of Commerce, San Sebastián, May 8, 2003.

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